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March 22, 2004

VIA ELECTRONIC FILING

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, SW,
Room TWB 204,
Washington, DC 20554

**Re: *Ex Parte*, WC Docket No. 02-112, Section 272(f)(1) Sunset of the BOC
Separate Affiliate and Related Requirements; CC Docket No. 00-175
2000 Biennial Regulatory Review, Separate Affiliate Requirements of
Section 64.1903 of the Commission's Rules**

Dear Ms. Dortch:

AT&T and other competitive carriers have shown in this proceeding that the Bell Operating Companies ("BOCs") possess market power by virtue of the in-region local bottleneck facilities that allow them to raise their long distance rivals' costs and restrict total output. Because long-distance competitors must use incumbent-controlled local access facilities to originate and terminate most of their customers' calls, the Supreme Court finds it "easy to see why" an incumbent local carrier "would have an almost insurmountable competitive advantage" in long distance.¹ Similarly, the Commission has recognized that "as long as the BOCs retain control of local bottleneck facilities, they could potentially engage in improper cost allocation, discrimination, and other anticompetitive conduct to favor their affiliates' in-region, interLATA services."² The Commission therefore underscored that nondominant treatment of BOC long distance services is "*predicated* upon their full compliance with the structural, transactional and non-discrimination requirements of section 272 and our implementing rules."³

Where those Congressionally-mandated safeguards are removed by the sunset of section 272, BOCs providing in-region long distance services on an integrated basis

¹ *Verizon Communications, Inc. v. FCC*, 122 S. Ct. 1646, 1662 (2002).

² *Regulatory Treatment of LEC Provision of Interexchange Services Operating in the LEC's Local Exchange Area*, 12 FCC Rcd. 15756, ¶ 134 (1997).

³ *Id.*

should comply with the Commission's longstanding Rule 61.58 requirement that "dominant carriers file tariffs setting forth the prices, terms and conditions for their interstate services."⁴ These requirements should apply until other adequate safeguards are developed to prevent the BOCs from advantaging their integrated long distance services through anticompetitive leverage of the local bottleneck, including comprehensive intercarrier compensation reform and meaningful constraints on BOC special access rates and non-price discrimination.

Predictably, the BOCs seek to avoid this straightforward answer to the issues raised by this proceeding, and to deflect attention from their ubiquitous local bottlenecks, by contending that new intermodal services will ensure continued long distance competition. Thus, Verizon devotes a significant amount of its 20-page February 13, 2004 *ex parte* filing and 76 pages of attachments to describing VOIP and cable telephony services, none of which serve more than a fraction of the number of customers served by the BOCs.⁵ The most successful VoIP service, Vonage, claims only to have "more than 100,000" lines in service,⁶ and all of the longer-established circuit switched cable telephony services serve only "about 2% of total switched access lines."⁷ Those seeking enlightenment rather than obfuscation from Verizon's February 13 filing should begin at the bottom of the final page of Verizon's final attachment to that *ex parte* -- where Verizon acknowledges, in response to questions by FCC Staff, that it controlled no fewer than 56 million switched access lines on December 31, 2003, and approximately 50 million lines if resale and UNE lines provided to CLECs are deducted. Indeed, incumbent local exchange carriers controlled about 175 million switched access lines in June 2003, and about 156 million lines if resale and UNE lines are deducted.⁸

The record shows that wireless and wireline services are not fully substitutable, and even if they were, BOC ownership of the two leading nationwide wireless carriers -- and the proposed acquisition of AT&T Wireless by Cingular -- greatly limits their role in providing any effective constraint on the exercise of BOC market power. Contrary to Verizon's claim that no wireless carrier would "pull its competitive punches" because of its BOC affiliation,⁹ the Commission has found that affiliations provide both the incentive and ability to engage in anticompetitive conduct, particularly when they involve controlling interests.¹⁰ Similarly, BellSouth recently charged that "a wholly-owned affiliate of the largest cable operators . . . plainly has the incentive" to engage in

⁴ *Review of Regulatory Requirements for Incumbent LEC Broadband Telecommunications Services*, 17 FCC Rcd. 27,000, ¶ 18 (2002). See also, 47 C.F.R. Section 61.58(a)(2)(i).

⁵ Letter dated February 13, 2004 to Marlene H. Dortch, Secretary, FCC, from Dee May, Verizon.

⁶ See http://www.vonage.com/corporate/press_index.php?PR=2004_02_19_0.

⁷ FCC Industry Analysis and Technology Division, Wireline Competition Bureau, *Local Telephone Competition: Status as of June 30, 2003*, at 2.

⁸ *Id.*, Table 4.

⁹ Verizon February 13 *ex parte* at 9.

¹⁰ See, e.g., *Market Entry and Regulation of Foreign Affiliated Entities*, 11 FCC Rcd. 3873, ¶ 80 (1995) (citing "ample precedent for our view that a less-than-controlling interest can provide a carrier with the incentive and ability to engage in anticompetitive conduct").

conduct benefiting those operators.¹¹ As the FCC International Bureau recently noted, “wireless carriers would be in a position to prevent [an incumbent local carrier] from exercising market power only if they were independently owned.”¹² Significantly, Verizon itself concedes there is no distinction between the actions of the BOCs and their wireless affiliates by contending in footnote 12 of its February 13 *ex parte* that actions of the BOCs’ wireless affiliates should be attributed to the BOCs:

“[T]here is no merit to AT&T’s assertion that BOCs are not providing local, long distance, and wireless bundles out of region and are unlikely to do so. All-distance wireless calling plans are local/long distance wireless bundles, and Verizon Wireless offers such plans in every state except Alaska, whether or not it has an ILEC presence.”

Even the ability of the diminishing number of independently-owned wireless carriers to constrain the exercise of BOC market power is limited by their reliance on BOC special access services. The comments by AT&T Wireless make clear that wireless carriers cannot avoid the BOC local bottleneck because they must use ILEC special access facilities to operate and expand their networks.¹³ AT&T Wireless states that there are no viable alternatives to these incumbent facilities and that “more than 90 percent of its transport costs go to paying ILECs for special access facilities.”¹⁴ Similarly, VoiceStream uses ILECs for 96 percent of its special access transport needs and Sprint has stated that ILEC special access is its largest operating cost.¹⁵ Verizon’s unsupported claim that wireless carriers “have a choice of providers for special access-type links” fails to rebut these facts because the record shows that CLEC alternatives to BOC special access services exist only in a very small percentage of cases.¹⁶

The record also demonstrates that the BOCs leverage their local bottlenecks to advantage their long distance services by engaging in price squeezes, cost misallocation and discrimination.¹⁷ AT&T, for example, has shown that Verizon and other BOCs engage in price squeezes of their long distance rivals by setting their long distance rates at or below their switched access prices.¹⁸ In response, Verizon asserts that “below cost pricing for only one of multiple dimensions of service (e.g., intrastate long distance calls

¹¹ *Implementation of Section 304 of the Telecommunications Act of 1996*, CS Docket No. 97-80, Comments and Opposition of BellSouth Entertainment, LLC, filed Feb. 25, 2004, at 4.

¹² *AmericaTel Corp. & Telecom Italia of North America, Inc.*, File Nos. ITC-MOD-20020502-00212 & ITC-MOD-20020502-00213, Memorandum Opinion and Order, rel. Dec. 30, 2003, at ¶ 20.

¹³ AT&T Wireless Comments, filed June. 30, 2003, at 8.

¹⁴ *Id.* at 9.

¹⁵ *Id.*

¹⁶ AT&T Comments, filed June 30, 2003, at 19-24.

¹⁷ AT&T has shown that price cap regulation does not prevent cost misallocation, contrary to claims by the BOCs, because the BOCs have incentives to misallocate costs, among other reasons, in order to make their earnings appear lower and thus obtain regulatory changes to the price cap system, and in order to inflate the UNE prices paid by their competitors. See Letter dated February 13, 2004 to Marlene H. Dortch, Secretary FCC, from Michael J. Hunseder, Sidley, Austin Brown & Wood, CC Dkt No. 02-33 & WC Dkt. No. 02-112.

¹⁸ AT&T Comments at 26-30.

in one state)) is justified on the grounds that "what matters is whether *services overall* cover *aggregate* costs."¹⁹ Verizon's approach would allow BOCs providing integrated long distance services after the sunset of section 272 to engage in rampant anticompetitive cross-subsidization by using high margin services like operator-assisted calls or vertical features to subsidize low long distance rates. For these reasons, as AT&T has demonstrated, the BOCs should remain subject to dominant carrier tariff filing and cost support requirements to prevent such conduct and the imputation requirements should be clarified to require the use of imputed access costs for each component in their bundled service offerings.²⁰

Verizon certainly fails to justify its anticompetitive use of access rates by arguing that AT&T charges higher access rates than Verizon.²¹ Verizon cites to a filing it made last summer in Virginia regarding AT&T's intrastate access charges, but fails to inform the Commission that AT&T's Virginia access charge rates were brought into parity with Verizon's rates three weeks later.²² Moreover, even with such parity of charges, because AT&T and other CLECs have a fraction of the local service customers of any competing BOC, the balance of access payments between CLECs and BOCs overwhelmingly favors the BOCs and allows the BOCs to price squeeze their competitors.

SBC has contradicted Verizon's claim in its February 13 *ex parte* that AT&T is "wrong in claiming that BOCs enjoy a substantial cost advantage over interexchange carriers."²³ A senior SBC executive told SBC's analyst meeting in November 2003 that "we believe we have a cost advantage over AT&T, MCI and others because they buy a lot of their local access from us or the other regional Bell companies."²⁴ SBC's statement also belies the BOC arguments in this proceeding repeated here by Verizon that the BOCs purportedly "have no economic incentive to engage in predatory pricing because access charges are a real source of revenue."²⁵ Access charges provide the BOCs with a cost advantage in the long distance market only if BOC long distance prices do not include the same access prices that are paid by other long distance carriers. These BOC arguments also fail to take account of the increased retail and access revenues the BOCs receive from increased demand for long distance calls when the BOCs reduce long distance prices and other long distance carriers reduce prices in response.

There is certainly no basis to Verizon's further claim in its *ex parte* that the BOCs cannot use access charges to harm long distance competition because "there are a multitude of competitors -- cable companies, wireless companies, and new VOIP providers -- who do not pay access charges to the BOCs."²⁶ Both cable and wireless

¹⁹ Verizon Feb. 13 *ex parte* at 14 (emphasis added).

²⁰ AT&T Comments at 49-50.

²¹ Verizon Feb. 13 *ex parte* at 14.

²² AT&T Communications of Virginia, LLC, Access Services Tariff, S.C.C. - Va. - No.10, Section 17, 1st Revised Page 24, effective June 27, 2003.

²³ Verizon Feb. 13 *ex parte* at 17.

²⁴ SBC Communications Analyst Meeting, Nov. 13, 2003, CCBN StreetEvents, Event Transcript, Final Transcript (Attachment B to AT&T's February 3, 2003 *ex parte*) at 14 (statement by SBC Group President for Marketing and Sales Rayford Wilkins) (emphasis added).

²⁵ Verizon Feb. 13 *ex parte* at 12.

²⁶ *Id.* at 17-18.

companies pay terminating access charges on at least a portion of their traffic. Even if cable and wireless companies were completely exempt from access charges, the above discussion makes clear that cable companies, wireless companies, and new VOIP providers would not prevent the BOCs from re-monopolizing the U.S. long distance industry if the BOCs were allowed to exploit their access cost advantage to drive wireline long distance carriers out of business.

Verizon also fails to rebut AT&T's showing in its November 26, 2003 and February 3, 2004 *ex parte* filings that bundled local and long distance services are a relevant product market in this proceeding under the analytical framework set forth in the DOJ/FTC *Horizontal Merger Guidelines*. This framework requires the determination of whether a hypothetical monopolist of bundled services could profitably impose a "small but significant and nontransitory increase in price" without losing sufficient customers to providers of non-bundled *a la carte* local and long distance services to defeat that price increase. Verizon's response (pp. 13-14) largely focuses on the availability of *bundled* services, when the relevant issue is the extent to which consumers would turn to non-bundled services to forestall a price increase. AT&T has shown that such a price increase would be profitable and Verizon does not show otherwise. Further, Verizon claims (p. 14) that "as a practical matter, any carrier would be foolish to price bundles any lower than it had to in order to maximize revenues," yet senior SBC executives repeatedly told the SBC analysts meeting in November 2003 that SBC has made "a conscious decision" to "reduce prices" and to "take some margin concession today" in order drive growth in bundles and retain customers.²⁷

AT&T would be pleased to answer any further questions.

Respectfully submitted,



cc:	M. Carowitz	W. Kehoe
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²⁷ SBC Communications Analyst Meeting, Nov. 13, 2003, Final Transcript at 3, 5 (statement by Rayford Wilkins, SBC Group Vice President for marketing and Sales); *id.* at 2 (statement by Edward Whitaker, SBC Chairman and CEO).